United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

76-1494

To be argued by
PHILIP A. LACOVARA

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

No. 76-1494

UNITED STATES OF AMERICA,

Appellee,

v.

ANTHONY M. NATELLI,

Defendant-Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF DEFENDANT-APPELLANT ANTHONY M. NATELLI

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INTRODUCTION

The strident tone of the government's brief is matched by the zeal displayed in its re-characterization of the evidence presented at appellant's trial. Having presented one version of the underlying events to appellant's jury and a different version to the juries before which Thomas Mullen was tried, the government presents this Court with yet a third version—one that supposedly establishes, in the government's words, appellant's "wilful connivance" with Randell and other

officers of NSMC to perpetrate a fraud. (Br. 6). The escalating war of words against appellant, trying to paint him as an architect of the NSMC fraud rather than as a victim of it, goes beyond what the government even attempted to prove at his trial. More important, it is demonstrably at odds with the facts, even granting the government the benefit of the "inferences" to which it is entitled at this stage of the proceedings. As a test of the accuracy of the government's presentation, we respectfully refer the Court to the statements made at the time of sentencing by Judge Tyler who, after presiding at the lengthy trial and hearing all the witnesses, including appellant, commented:

> "... I think you are absolutely sincere when you say that you do not believe that you did anything wrong in this audit or audits for the National Student Marketing. After thinking about this matter for a long time I think you honestly mean that. But the tragedy is that this jury found that this was an audit or audits done with reckless disregard for what was really involved. We know that because of the record showing what it did in the jury deliberation.
>
> I am frank to say that I don't suppose in my experience as a nisi prius judge for almost 13 years that I have probably dealt with any two men who are more generally reputable, and deservedly so, than you are." (JA 174)

Judge Tyler would hardly have offered those anguished remarks if the rhetorical assaults now being directed at appellant by the government were supported by anything in the trial record, including the most generous inferences that could be drawn in the government's favor. It is important to remember that Randell and Kelly were prosecuted for acts that expressly included defrauding the accountants, including appellant, and that when they entered their guilty pleas prior to appellant's trial they acknowledged deliberately concealing the true facts from appellant.

How, then, can it be claimed now that appellant "willfully connived" with Randell and the others? The government has, to put it charitably, embellished the evidence at appellant's trial, while at the same time accusing us, through a dazzling display of adverbs, of distorting the record.[1] Although particular inaccuracies in the government's brief will be addressed at pertinent points in the argument below, we shall first deal with several "facts" given prominence in its presentation.

Perhaps the most extraordinary feature of the government's brief is the theme that appellant "suggested" percentage-of-completion accounting to accommodate NSMC's management – indeed, that appellant "devised" the accounting method for that purpose. (Br. 8, 35.) The truth is that accrual of a percentage of income on contracts not yet completed was a recognized accounting method in 1968 and continues to be. *See, e.g.*, H. Finney & H. Miller, Principles of Accounting 206-09 (6th ed. 1965). Appellant was neither the first accountant to use percentage of completion accounting nor the first to apply it to NSMC. Prior to the engagement of PMM as outside accountants, NSMC had, with permission of a C.P.A. retained to advise the company, accrued a substantial percentage of income attributable to fixed-fee programs based upon *oral* commitments. The financials for May 31, 1968, released by NSMC before PMM's engagement began, reflected this accrual. (Tr. 469-482; Gx. 46A, Nx. B & C). That was the situation which confronted appellant when he first became acquainted with this new and rapidly-expanding company, whose stock had risen from $6 in April 1968 to $80 per share by September, before any financials had been reported on by PMM. *See* 527 F.2d at 315. Before permitting the company to continue to accrue a percentage of income on

[1] Although we believe the accusations to be unfounded, there is not sufficient space here for us to respond to each and every accusation of "distortion" that appears in the 97 pages of the government's brief. In the course of the argument, we shall address those which appear most pertinent. With respect to the remainder, we respectfully refer the Court to the record materials cited in our opening brief.

fixed-fee programs, appellant considered and rejected a "completed contract" method as well as a method, pressed vigorously by Randell, that would have permitted accrual of the *entire* amount of revenue on a fixed-fee program, not merely a percentage. (Tr. 1823-1838.)

The government devotes a considerable part of its brief to the retroactive write-off of some revenues so accrued and reported in the audited financials for the year ended August 31, 1968, a matter that pertains to the first specification of the indictment. Although that first specification is not the subject of this appeal, we cannot allow silence in the face of the government's presentation to imply an acknowledgement of criminal conduct on appellant's part. Omitted from the government's brief is the explanation for the bulk of the write-offs: the discovery, communicated to appellant in the spring of 1969, that NSMC's former Director of Marketing had fabricated certain fixed-fee commitments reported to the accountants and included in the August 1968 financials, a fraud which had resulted in the discharge of the employee involved. Because the "commitments" fraudulently reported by the since-dismissed employee would never have been recorded if the true facts had been known, appellant determined that there should be a restatement of the August 1968 figures. (Tr. 1853-1857.)

The restated financials for the year ended August 31, 1968, appearing in the 1969 proxy statement, reflected a "pooling" of NSMC's revenues and earnings with those of the companies NSMC had acquired in the interim. This "pooling" was (and still is) required by generally-accepted accounting procedures, as prescribed then in AICPA Statement on Auditing Procedure No. 40; it was not, as the government implies (Br. 10-11), some kind of artifice devised by the accountants. A footnote to the financial statements (which was *not* required by then-effective accounting procedures) showed separately the revenues and earnings of NSMC as originally reported and the adjustment to reflect the addition of the new subsidiaries. The

write-off from the originally-reported August 31, 1968, earnings was not shown separately in this footnote. At trial, appellant testified that he concluded such disclosure unnecessary because: (1) he did not view the primary cause of the write-off, the defalcation of a single employee, as a recurring problem, since the employee had been fired and appellant had by then taken the initiative in getting the company to use written commitment letters; (2) in view of a tax credit adjustment which PMM's tax department then thought necessary to make, the $21,000 net effect of all adjustments to NSMC's originally-reported August 1968 earnings did not appear material. Appellant had made the decision concerning disclosure only after considering alternatives, including a narrative statement which appellant himself drafted, and discussing the matter with his firm's SEC reviewing partner, Leon Otkiss, who concurred in his decision. (Tr. 1747-1751, 1906-1910.)

There was, therefore, considerable evidence from which the jury could have found that appellant's decisions concerning the audited financials appearing in the proxy statement were made entirely in good faith and involved no violation of a statute punishing fraud. How the jury resolved the issue can never be known, since it was expressly instructed that it could convict on either the first specification or the second. It was the *second* specification, of course, involving the inclusion of Eastern revenues and earnings in the later unaudited financials, on which the government concentrated much of its fire in argument to the jury. Appellant's conviction stands or falls on the adequacy of the proof concerning Eastern, as this Court recognized previously when it reversed the conviction of appellant's co-defendant on direct appeal. 527 F.2d at 322, 329. Without in any sense conceding the sufficiency of the government's proof as to the first specification, we turn to the deficiency in the government's evidence concerning Eastern.

ARGUMENT

I.

THE GOVERNMENT'S FAILURE TO PRESENT ANY EVIDENCE ON A CRITICAL ELEMENT OF THE OFFENSE RENDERS APPELLANT'S CONVICTION INVALID.

A. Proof Of The Falsity Of The Eastern Airlines Commitment Was Essential For A Valid Conviction.

Apparently recognizing the gap in its proof regarding the falsity of the Eastern commitment, the government now contends that it did not have to submit any such proof in order to obtain a valid conviction. (Br. 32-44.) The Government argues that, totally apart from Eastern, it discharged its burden under the second specification in two independently sufficient ways: (1) by proving that appellant used a "totally misleading method" of accounting for the nine-month earnings statement (Br. 35) and (2) by offering evidence that appellant included in that earnings statement "eleven specific 'commitments' totalling $320,172" which were "worthless or at best uncertain" (Br. 44).

A dispositive indicator of the lack of merit to this argument is the government's failure even to assert it earlier in this litigation. Its brief to this Court on direct appeal contained no suggestion that either the accounting method employed by NSMC or the inclusion of eleven other small commitments (the "Oberlander contracts") sufficed to sustain the conviction under the second specification (G. Br. No. 75-1004, at 14-17, 30-32, 40-42.) Similarly, the government's brief in opposition to appellant's certiorari petition, while mentioning the Oberlander contracts, treated the Eastern contract as the essence of the nine-month earnings statement specification. (Br. in Opp., Sup. Ct. No. 75-808, at 7-10.)

A brief analysis of the government's two alternative bases for proving the second specification may explain why the government has not previously advanced them. The flaw in the government's present argument is apparent from the *complete* text of the second specification in the indictment:

> "Said proxy statement also contained an 'unaudited' statement of earnings for the nine months ended May 31, 1969 which stated 'net sales' at $11,313,569 and 'net earnings' as $702,270. Those figures were materially false and misleading *because, as the defendants well knew at the time the proxy statement was filed, "net sales" for that period were less than $10,500,000 and NSMC had no earnings at all.*" (JA 11) (emphasis supplied.)

Inexcusably omitting the critical, italicized portion of the specification from its quotation (Br. 33), the government argues that the accounting method used by NSMC in the nine-month earnings statement sufficed to prove that the statement was "materially *misleading.*" (Br. 39) (emphasis in the original). But, as is apparent from the face of the second specification, the government was required to prove that the unaudited statement was *false* because – as the indictment expressly alleged – it overstated net sales by more than $800,000 and net earnings by more than $700,000 – amounts attributable primarily to Eastern. Indeed, while the government now castigates appellant for "never once mentioning 'misleading' " (Br. 33 n.*), the government expressly acknowledged in the district court that it was "required to prove, among other elements of the crime, that these statements of sales and earnings were *in fact false.*" (G. Mem. in Opp. at 50-51) (emphasis added).

Similarly, the government's alternative contention – that proof regarding "eleven specific 'commitments' totalling $320,172" "alone" established the crime charged under the second specification – simply cannot be reconciled with the

terms of the indictment. The Eastern contract, representing more than $500,000 of the alleged $800,000 overstatement of net sales charged in the specification, was plainly critical to the government's case.

The government's reliance on the alleged falsity of the Eastern contract in all its prior briefs and arguments accurately reflects the central role that commitment played at trial. During his summation, the prosecutor explained the importance of the Eastern contract to his case. He informed the jury that the second specification in the indictment charged that "sales for National Student Marketing for the nine-month period were overstated by about $800,000." (JA 124.) He then pointed to the Eastern contract as providing the bulk of the alleged overstatement of sales and earnings, (JA 125).[2]

This Court's opinion on direct appeal agreed that the core of the second specification was the alleged falsity of the Eastern contract. Indeed, the Court characterized the Eastern commitment as "the major item" under that specification, 527 F.2d at 322, and discussed the second specification in sections of its opinion captioned "The Eastern Commitment and the Nine-Month Earnings Statement" and "The Eastern Commitment"! *Id.* at 320, 322. And in its opinion on co-defendant Scansaroli's petition for rehearing, the Court expressly noted that the Eastern commitment was "*an essential part* of the 'nine-month earnings statement' specification." *Id.* at 329 (emphasis added). Moreover, the government can hardly rest exclusively on evidence pertaining to the Oberlander contracts in view of this Court's determination on direct appeal that this evidence "would have been too equivocal to support proof beyond a reasonable

[2]While Judge Tyler's charge to the jury mentioned Eastern a number of times (JA 162-63, Tr. 2391), he never authorized the jury to convict if they concluded that percentage-of-completion accounting was "misleading" or that the Oberlander contracts were "uncertain."

doubt that [inclusion of these contracts] was not a mere error of judgment." 527 F.2d at 322.[3]

In short, it is now far too late for the government to shift its footing away from Eastern if it wishes to sustain appellant's conviction.

B. The Government Failed To Prove The Falsity Of The Eastern Commitment.

The circumstantial evidence on which the government and this Court relied to conclude that appellant acted "knowingly" within the meaning of section 32(a) of the Securities Exchange Act of 1934 did not establish the separate element of falsity. It established only, in light of the jury verdict, that appellant acted in reckless disregard of the truth or falsity of the Eastern contract by including it in the earnings statement without "pursu[ing] the matter further" and "insist[ing] upon some independent verification." 527 F.2d at 322, 320. The government ignores the fact that this was a "reckless disregard" case when it argues that, in finding that appellant acted "knowingly," the jury must have found that the Eastern commitment was false. The logic of that argument is doubly defective. First, *actual* knowledge of some underlying falsity was not the predicate for this conviction.[4] As Judge Tyler

[3] While this statement is contained in a portion of the Court's opinion dealing with Scansaroli, there is no reason why it is not equally applicable to appellant in view of the fact that the record reflects that Scansaroli was more intimately involved in the decision to include these contracts in the earnings statement. (Tr. 4[illegible] 2093-95.)

[4] On direct review, this Court reversed the conviction of appellant's co-defendant, holding that he had not "acted in reckless disregard of the facts" because he bore no duty "to be suspicious of the Eastern commitment and to pursue the matter further." 527 F.2d at 322. Appellant, however, was expressly found to have had such a duty. *Id.* at 320, 322. Although acknowledging that appellant was dealing with an unaudited statement, this Court held that he was obliged "to go beyond the usual scope of an account's review and insist upon some independent verification." *Id.* at 320. It was appellant's failure to take the step of "seeking verification from Eastern" that, in the Court's view, made it appropriate to affirm the conviction on a "reckless disregard" theory. *Id.* at 320, 323.

stated at sentencing: "the jury found that this was an audit or audits done with reckless disregard for what was really involved. We know that because of the record showing what it did in the jury deliberation." (JA 174.)[5] Second, the issue is not whether the jury was induced to assume or find the falsity of Eastern, but whether there was any evidence to support such a finding.

The government's extended discussion of the use of circumstantial evidence erects a straw man and then proceeds to dismantle it. Appellant has not questioned the general propriety of using circumstantial evidence to prove the essential elements of a crime. Where we diverge is on the question whether the same circumstantial evidence used to show a culpable state of mind here was legally sufficient to prove actual falsity. We contend that proof that appellant "recklessly" stated as facts matters of which he was ignorant, although found legally adequate to charge him with acting "knowingly," cannot logically constitute proof of the actual falsity of the statement made.

The central question is whether the government presented proof that the Eastern commitment was *in fact* false. The government concedes that it offered "no proof" indicating

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[5]The government's present claim that appellant's conviction was based on *actual* knowledge of the falsity of the nine-month earnings statement turns on its highly formalistic interpretation of Judge Tyler's instructions to the jury (Br 18-19 n.*) – an interpretation which Judge Tyler's own sentencing remarks belie. The government omits developments that are critical to understanding what the jury's verdict established. Following the initial charge in which the jury was told it could convict if it found appellant "recklessly stated as facts matters of which he knew he was ignorant" (Tr. 2364-65), the jury sought further instructions on the definition of "wilful and knowing." (Tr. 2400). Judge Tyler responded with an explanation omitting any reference to recklessness. (Tr. 2400-2401). The jury, after further deliberations, reported itself deadlocked (Tr. 2420) but later sought further explanation of "the term 'knowing.'" (Tr. 2426). This time Judge Tyler returned to the initial recklessness formulation (Tr. 2427), and the jury thereafter found appellant guilty. As Judge Tyler noted, the course of the jury deliberations demonstrates that appellant's conviction was based on a finding of reckless disregard.

that Eastern commitment was not "legally binding." (Br. 42). And, of course, the government offered not one word of testimony about the collusion between Mullen and Randell to conceal the secret side letter, making the commitment letter cancellable, from appellant and the other PMM accountants. Yet, it contends that it introduced circumstantial evidence demonstrating that the Eastern commitment "was a sham and should not . . . have been booked as sales and earnings." (Br. 45). The "evidence" relied upon by the government consists of (1) alleged irregularities in the Eastern commitment letter, (2) the alleged absence of NSMC records pertaining to the Eastern sale, and (3) two prior occasions in which unbilled accounts receivable had been booked following the close of the reporting period and later written off by NSMC. Whether taken singly or together, that "evidence" does not constitute proof of the falsity of the Eastern commitment.

For the first time at any stage of this litigation, the Government presents the remarkable argument that the Eastern commitment letter (JA 179) itself proves the falsity of the Eastern contract.[6] (Br. 49-51.) Among the alleged irregularities on which this argument rests is the wording of the letter which the government suggests literally means that "Eastern is going to get $820,000 in cash from NSMC rather than vice versa." As the government itself notes, this reading of the letter "can not be right." (Br. 49.) The government, which elsewhere in its brief displays admirable understanding of inadvertent grammatical imprecision (Br. 67-68 n.*), here refuses to accept the clear message of the letter — that Eastern agreed to utilize not less than $820,000 worth of NSMC's services during fiscal year 1970. Next, the government claims a "departure" from the form commitment letter

[6]It is instructive to note that in the district court the government described the Eastern Airlines letter as being "in the approved form." G. Mem. in Opp. at 12. Moreover, in both *Mullen* trials, the government argued that Randell and Kelly had deceived the accountants (including appellant) by securing the letter from Mullen, confirming a firm commitment from Eastern, to replace the Pontiac letter that had been rejected by appellant as not being in the proper form. (JA 242-44, 294-95).

(JA 183) in that the Eastern letter included the date on which the verbal commitment was given to NSMC. Since the form contemplates that the prior verbal commitment that is being confirmed will be referenced in the letter, it is hardly a telltale sign of fraud (as the government seems to argue) that the Eastern letter included the date of the prior verbal commitment as well as the identity of the person to whom it was given.[7] Finally, the government alleges that, since the letter was dated August 1969, it was not effective to permit accrual of sales and earnings for the period ended May 1969. But the point of requiring a written commitment was to insure the enforceability of the contract. A written memorandum of an oral commitment simply satisfies the Statute of Frauds and does not alter the time at which the contract was formed. *See* A. Corbin, *Contracts*, §503, at 480-81 (one vol. ed. 1952). In short, these purported irregularities now ingeniously conjured by the government are devoid of substantive significance, were never treated by Judge Tyler or the jury as evidence of the falsity of the Eastern contract, and cannot now plug the hole in the government's case.

As the second argument for a circumstantial showing of falsity, the government claims that "[f]urther proof that the Eastern commitment was objectively false" was supplied by the absence of documents pertaining to the contract. (Br. 52). But the lack of records would be of evidentiary (as opposed to rhetorical) value only if such records normally would be

[7] As still a further alleged "indicia of fraud," the government notes that the letter states that the proposal was "originally submitted on May 7, 1969" and orally accepted on May 14, 1969. (Br. 51 n.*). The government asserts that it is "[in]credible that a company like Eastern would make such huge future commitments on such a spur-of-the-moment basis." *Id.* What the government overlooks is that, as shown by the time sheets appellant examined before allowing the Eastern figures to be included (JA 184-209, Tr. 1928-30), the formal proposal submitted on May 7 was the product of extensive discussions over a number of months between NSMC's account executive, Bob Bushnell, and Eastern's Manager of Special Markets, Tom Mullen. *See* Brief of Defendant-Appellant at p. App. 11. This rather obvious explanation indicates that there is nothing sinister about the dates contained in the Eastern commitment letter.

maintained for any valid contract. The government does not deny that other commitments that had no more extensive documentation were valid and ultimately resulted in the actual realization of cash income. The absence of billing, expenditure, and booking records is simply a by-product of the percentage-of-completion method of accounting employed by NSMC rather than evidence of the falsity or invalidity of the Eastern commitment.[8] Significantly, the government also does not dispute the fact that NSMC's work records showed that its account executive for Eastern had spent substantial time on the program proposal prior to the end of the nine-month period (Br. 67) – a fact plainly inconsistent with the assertion that the Eastern transaction was a 3:00 a.m. sham. Finally, the fact that the contract was not booked by NSMC until after the commitment letter was received was consistent with NSMC's approved procedures, instituted at appellant's urging, that only contracts supported by legally binding written confirmations could be taken into sales and earnings. (Tr. 530, 673, 1846-50; Gx. 16, E 130).

The final item of circumstantial evidence which the government asserts "alone" proved the falsity of the Eastern commitment is that on two prior occasions NSMC had booked commitments as unbilled accounts receivable after the close of the reporting period, only to write off the sales later as uncollectible. (Br. 45-46). The government argues that the Eastern contract was a similar last-minute unbilled account receivable and, therefore, based on the "pattern" established by the two prior incidents, the jury could conclude that it too was invalid. The initial failing in the government's argument is that, as a recent decision of this Court indicates, "similar act

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[8]The lack of billings to Eastern in August 1969 is understandable since performance of the contract was not scheduled to commence until 1970. Similarly, the absence of expenditure records merely reflects the fact that costs to NSMC (other than the time of the account executive who designed and sold the program) although accrued were not incurred until the year of performance.

evidence" may not be employed to such ends. *United States v. Robinson*, 545 F.2d 301 (2d Cir. 1976). There this Court held, in the context of a charge of possessing checks stolen from the mails, that similar act evidence, "although relevant and admissible to prove Robinson's knowledge of theft, was not relevant to prove that any particular check covered by the indictment was stolen from the mails. Fed. R. Evid. 404(b)." *Id.* at 304.

An even more basic flaw is that there is no pattern of similar occurrences supporting the inference argued by the government. The first allegedly similar incident relied upon by the government was the booking of some $1,700,000 in unbilled accounts receivable in the fall of 1968 after the close of the company's fiscal year in August 31, 1968. The contracts booked on that occasion were supported by account executives' representations that they had been given *oral* commitments from purchasers. No written confirmations were involved. *See* 527 F.2d at 315. Subsequently, approximately $1,000,000 of these sales were written off, *id.* at 316, but the remainder of these post-period bookings were *not* shown to be defective. All of the write-offs involved *oral* commitments and $750,000 of the total were attributable to a single account executive who had reported non-existent commitments and had been fired. *Id.*

The second incident cited involved the booking of the Pontiac commitment after the close of the six-month period ending February 28, 1969. The Pontiac item was written off on appellant's instructions not because appellant believed it was "bad" or "phony," but, solely because it was not confirmed by a written commitment letter in the form drafted by NSMC's counsel to assure that commitments would be legally enforceable. (Tr. 530, 673, 1915).[9] As of the date on which the

[9] The Pontiac commitment letter turned out to be a forgery created by Randell and Keily through doctoring of a letter stating only that Pontiac was considering an NSMC proposal. Although the government attempts to create a contrary impression in its brief (Br. 48), appellant had no knowledge of the forgery at the time he disallowed the Pontiac commitment and included the Eastern contract. Although the government's arguments to the jury seemed to assert that the Eastern commitment letter was a forgery – a "phony" – it was not. The purported "pattern," even with the benefit of hindsight, dissolves into thin air.

Eastern contract was received, NSMC had not written off a single contract supported by a *written* commitment in the prescribed form. (Tr. 1283-85; Gx. 16, E 130-133). The apparently enforceable written commitment from Eastern, therefore, hardly fits any "pattern" that would prove the Eastern commitment was invalid.

Even viewed in the light most favorable to the government, the "circumstantial evidence" establishes only that, as this Court found, the "Eastern contract was a matter for deep suspicion." 527 F.2d at 320. As we noted in our opening brief, such evidence cannot suffice to discharge the government's burden of proving that the Eastern contract was in fact false because "it is well settled that a jury is not justified in convicting a defendant on the basis of mere suspicion." *United States v. Barker*, 542 F.2d 479, 485 (8th Cir. 1976). The most vivid illustration of the deficiency in the government's proof is this simple fact: all the "suspicious" circumstances alleged by the government would have been present if the commitment letter from Mullen had been the most iron-clad contract ever drawn. *Compare United States v. Robinson, supra.* And if the Eastern contract *was* valid surely appellant cannot stand convicted. For all the jury had a basis in evidence to know, however, the commitment was legally binding.

C. The Government's Failure To Present Proof Of An Essential Element Of The Crime Justifies Granting Collateral Relief In This Case.

The government's contention that the issue of the falsity of the nine-month earnings statement has been previously adjudicated necessarily rests on this Court's prior decision since the Supreme Court's denial of appellant's certiorari petition " 'imports no expression of opinion upon the merits of the case.' " *Brown v Allen*, 344 U.S. 443, 492 (1953), quoting *United States v. Carver*, 260 U.S. 482, 490 (1923). But, as we noted in our opening brief (p. 31) this

Court's prior opinion did not deal explicitly with the issue. Here, again, the government resorts to creative use of elipses, asserting that this Court "expressly held" that a true disclosure "would have shown that . . . NSMC had no profit" during the relevant nine-month period. (Br. 23.) The Court actually stated "that *without these unbilled receivables* Marketing had no profit in the first nine months of 1969," 527 F.2d at 318 (emphasis added). When read with the italized portion that was omitted by the government, it is evident that the passage is simply a recognition of the importance of those receivables, not a finding that NSMC *in fact* had no profit during the nine-month period because the Eastern commitment was proven to be false. Nowhere did the court deal expressly with the issue the appellant is advancing, nor was there any explanation in the Court's opinion what evidence in the record may establish the falsity of Eastern.[10]

Recently this Court held in *Gates v. Henderson*, ____ F.2d ____ (2d Cir. No. 76-2065, decided January 12, 1977), that federal collateral relief was available to a state prisoner seeking to raise a search-and-seizure claim, notwithstanding the Supreme Court's decision in *Stone v. Powell*, ____ U.S. ____ (44 U.S.L.W. 5313) (1976). This Court held that, even though the defendant had raised the objection unsuccessfully in the trial court and also sought to advance it on direct appeal and state *coram nobis* proceedings, *Stone v. Powell* did not preclude relitigating the claim, reasoning in part:

> "The state trial court here simply 'overruled' appellant's objection, with no statement of either factual or legal grounds, and none of the reviewing courts even mentioned the objection." (Slip op. at 1354).

That is precisely the situation in the present case. Although appellant has repeatedly tried to direct the attention of the

[10]The Court understandably focused on the primary legal question being litigated: whether "recklessness" was a sufficient basis for conviction for having acted "willfully and and knowingly."

courts to the critical failure of proof, not a single judge has addressed the objection to explain why it is not well founded.

Even assuming that the falsity of the nine-month earnings statement was considered *sub silientio* on direct appeal, appellant should not be foreclosed from obtaining relief in this case. The general rule barring relitigation of issues rejected on direct appeal is prudential, not jurisdictional – it "is not one defining power but one which relates to the appropriate exercise of power." Consequently, it is "not absolute" but may "yield to exceptional circumstances where the need for the remedy afforded by the writ is apparent." *United States v. Loschiavo*, 531 F.2d 659, 633 (2d Cir. 1976), quoting *Sunal v. Large*, 332 U.S. 174, 180 (1947); *accord Robson v. United States*, 526 F.2d 1145, 1147 (1st Cir. 1975).

Exceptional circumstances exist here where the government has secured the felony conviction of a previously respected professional, virtually destroying his career, on a record lacking proof of an essential element of the offense. Such an error presents "the worst type of fundamental unfairness" creating "a fatal constitutional taint for lack of due process of law." *United States v. Liguori*, 438 F.2d 663, 669 (2d Cir. 1971). Courts, including this Court, have vacated convictions on collateral review because of the lack of relevant evidence of record to support a critical element of the offense charged.[11] The government correctly notes that many of those cases involved situations in which the government made no attempt to introduce the requisite proof because of what turned

[11] *See e.g., United States v. Loschiavo, supra; Robson v. United States, supra; United States v. Travers*, 514 F.2d 1171 (2d Cir. 1974); *United States v. Liguori, supra.*

out to be a mistaken view of the law.[12] (Br. 30-31 n.*.) But surely the fundamental unfairness in those cases warranting relief on collateral attack is not dependent on the reasons why the record lacks adequate evidence of guilt. Rather, the essential unfairness is the preservation of a judgment of conviction, with its grave attendant consequences, after it becomes apparent that the record is devoid of evidence of guilt of the offense charged.

The interests of finality and judicial economy, much extolled by the government here, are doubtless important, but they are at most cause to hesitate, not shackles to prohibit relief if our submissions are otherwise sound. Our system of justice is not so wooden that concerns about the process are more important than the goal of substantial justice. *Sanders v. United States*, 373 U.S. 1, 8 (1963).

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[12] *See, e.g., United States v. Loschiavo, supra; United States v. Travers, supra; United States v. Liguori, supra.*

Contrary to the government's assertion, *Robson v. United States, supra,* did not involve "an intervening change of the law that occured after the direct appeal." (Br. 31 n.**). The First Circuit held that Robson's conviction had to be set aside as a violation of due process because the government failed to introduce proof establishing a "reasonable basis by which petitioner could have been found guilty of failing to keep his local draft board advised 'of the address where mail will reach him.'" 526 F.2d at 1148-49. The requirement that the government offer such proof to obtain a valid conviction was based on a 1943 Supreme Court decision, *Bartchy v. United States*, 319 U.S. 484. While the First Circuit had rendered a relevant decision on the issue after Robson's direct appeal, that case was consistent with, rather than a change in, the existing case law. *See United States v. Malde*, 513 F.2d 97, 99-100 (1st Cir. 1975).

II.

THE PRESENTATION OF AN ERRONEOUS VERSION OF THE FACTS BY THE GOVERNMENT THROUGHOUT THE TRIAL REQUIRES A NEW TRIAL OR, ALTERNATIVELY, A HEARING IN THE DISTRICT COURT.

A. The Government *Did* Present An Erroneous Version Of The Critical Facts.

In opening brief, we called attention to the prosecutor's repeated references to the Eastern contract as something "hatched at three o'clock in the morning at the printer's" (JA 35) and showed that his repetition of this theme of fabrication at the supposedly sinister hour of 3:00 a.m. in his remarks to the jury were bound to have had a decisive impact upon the verdict. We then showed that the prosecutor's remarks to the jury have been contradicted by later testimony of Cortes Randell, a government witness in a trial that began after this Court issued its July 1975 opinion affirming appellant's conviction.

At the outset, we wish to dispose of any insinuation that this point is foreclosed by prior adjudication. While the government accuses appellant of making an "attempt to re-litigate an issue raised by him on direct appeal and decided adversely" (Br. 61), the fact is that the question presented here has not been addressed by *any* court on direct appeal. We are frankly astonished that the government even makes this contention, since the Solicitor General, opposing appellant's certiorari petition, expressly represented to the Supreme Court that the courts below had *not* decided this particular question presented and argued that for that reason the Supreme Court should deny review:

> "Whatever the merit of petitioner's allegations of prosecutorial misconduct, they obviously are not suited for resolution *by this Court in the first instance.* The

> proper procedure is for petitioner to present his contentions to the district court in a motion for a new trial under Rule 33, Fed. R. Crim. P., or a motion to vacate his sentence under 28 U.S.C. 2255. A denial of certiorari would not preclude his following either of those paths." (Br. in Opp., Sup. Ct. No. 75-808, p. 30, emphasis added).

This is precisely the course we have pursued, and the government's attempt to retrench now is intolerable.

Turning to the merits, the government offers four arguments why, now that it has procurred several convictions by presenting different versions of the underlying facts to the different juries involved, the court should refuse relief. Essentially, the government argues (1) that the later testimony of Cortes Randell does not materially contradict the prosecutor's statements to appellant's jury; (2) that in the event of inconsistency between the prosecutor's statements to appellant's jury and Randell's later testimony, the later testimony must be deemed untrue; (3) that the prosecutor's statements to appellant's jury were supported by the testimony at appellant's trial; and (4) that any inaccuracy in the prosecutor's statements to appellant's jury are excused by the supposition that appellant could have contradicted them. We shall deal with the first three of these arguments in this section, and address the fourth in the section following.

1. The prosecutor's statements to appellant's jury *are* materially in conflict with later evidence.

The government purports to reconcile the prosecutor's statements about Eastern to appellant's jury with Randell's subsequent testimony as a government witness by seizing upon Randell's acknowledgement in the *Mullen* trial that Mullen lacked actual authority to bind Eastern and that no other Eastern official had agreed to purchase NSMC's

services.[13] (Br. 77-79.) While it is true that Randell so testified, the government's observation misses the point. The significance of Randell's *Mullen* testimony lies in its confirmation that (a) Bushnell had worked with Mullen to develop a promotional program for Eastern, and (b) that Mullen "had agreed to go ahead with the program back in May." (JA 263). These statements – which are also confirmed by Randell's later deposition testimony in the SEC civil action – plainly contradict the statements by the prosecutor to appellant's jury that Eastern was "hatched" at the Pandick Press at the supposedly sinister hour of 3:00 a.m.

The government now tries to minimize this contradiction by offering a narrow construction of the statements to appellant's jury never suggested at trial. The government says the prosecutor meant only that the Eastern *letter* had not appeared before 3:00 a.m., not that there was no legitimate basis for Eastern in NSMC's prior activities. But the prosecutor's statements at appellant's trial were much broader: that Eastern had been "hatched" and that "*nobody*" at NSMC had previously mentioned "this enormous sale." (JA 25, 35). Judge Tyler himself, summarizing the "high points" of the government's case for the jury, stated to the jury that the government contended that "nobody, nobody, least of all Scansaroli and Natelli, had ever heard of the Eastern Airlines commitment until the wee hours of mid-August when they were here at Pandick Press." (JA 162-163.) This contention flies in the face of Randell's later testimony that not only had NSMC presented a program to Eastern involving many hours of work, as NSMC's records showed, but also that Mullen had

[13]The government accuses us of concealing this aspect of Randell's testimony by "adroit use of ellipses and quotations out of context." (Br. 77, n.*). It is a fact, however, that the passage of Randell's testimony quoted on the same page at which this accusation appears is also quoted twice at page 20 of our opening brief.

"agreed to do the program back in May," as the commitment letter shown appellant indicated on its face.

But, suggests the government, Mullen's agreement in May is irrelevant because it would not have been "sufficient basis" for the inclusion of Eastern figures for the financial period ending in May. (Br. 78, n.**.) Of course, appellant has never contended that an oral commitment alone would have justified inclusion of revenues attributable to the Eastern commitment, for appellant permitted the inclusion of Eastern in the nine-month financials only after (1) learning from Randell prior to August 15 that there was a substantial oral commitment;[14] (2) receiving a commitment letter signed by Mullen indicating on its face that Eastern would purchase $820,000 of NSMC's services pursuant to a program submitted in May and agreed to orally that month; (3) reviewing a proposal which the Eastern account executive had in fact submitted; and (4) reviewing NSMC time records which substantiated the work the account executive, Robert Bushnell, had devoted to the program.

In sum, the prosecutor was telling the jury that the contract was just a "phony,"[15] that there was nothing in NSMC's prior

[14] Illustrative of the government's series of strident *ad hominems*, the government questions our candor, (Br. 64, n.*), because appellant, when testifying, never used the words "substantial oral commitment," as we had paraphrased it in our opening brief (p. 37). The record, however, shows that appellant was asked when he had learned about a "large commitment from Eastern Airlines" and replied that he had "heard about *it* [i.e., the 'large commitment']" from Randell who stated that "there was an Eastern *contract* which they, [NSMC], expected to be receiving within days." (JA 88 emphasis added.) We are at a loss to see anything disingenuous in describing the oral promise of a "large" forthcoming written contract as a "substantial oral commitment."

[15] The use of the word "phony" in conjunction with repeated assertions that Eastern had been "hatched," that it appeared "by magic" at 3 a.m., that NSMC was "making these things up" (JA 35, 37, 125, 126) – all this, we believe, necessarily led the jury to believe it was a forgery, contrary to actual fact. While it is true that "phony" does not necessarily mean "forgery" in every context, a synonym given for "phony" is "counterfeit," and when a document is labelled "phony" the suggestion frequently intended and communicated is that it is a forgery. If there is any doubt of this, it may be dispelled by reference to the government's opening statement in Mullen's bribery trial (cited by the government as *Mullen II*), in which the prosecutor refers to the Pontiac contract as a "phoney" [*sic*] because the Pontiac letter was a "forgery." (JA 294).

activity that would furnish any basis for including the Eastern contract and, inferentially, that appellant was lying in testifying to the contrary. These critical statements, however, are contradicted by Randell's later testimony.

The obligations of fair play which the government must observe even in its role as advocate are violated not only when a prosecutor makes literally false statements to a jury but also where a jury is given a "false impression," *Alcorta v. Texas*, 355 U.S. 28, 31 (1957), or when the prosecutor makes "insinuating" remarks contrary to actual fact, *United States v. Burse*, 531 F.2d 1151, 1154 (2d Cir. 1976). Whether intentionally or not, those obligations were violated here.

2. The prosecutor's version of events at appellant's trial can no longer be credited.

When forced to confront the contradiction between statements to appellant's jury and the later testimony given by Randell as a government witness, the government insists that the Court should believe only the former. The reason, the government indicates, is that Randell is a "crook and a liar" and that while the government called him as a witness it did not "vouch" for the testimony he gave. (Br. 76, 79-80.)

It is true that the procesutor at the *Mullen* trials did state, in a passage cited by the government (Br. 76-77, n.*), that Randell was "no friend of the government" even though being called as a government witness. (JA 320.) The central thrust of the prosecutor's remarks in the passage cited, however, was that Randell's testimony should *not* be discredited. The prosecutor explained that while Randell was a "crook and a swindler," the government could call no one else and that the jury should not refuse to believe him simply because of his criminal involvement.

The prosecutor accurately predicted the substance of the testimony he would elicit from Randell and relied on it in seeking Mullen's conviction. In his opening statement he

described Eastern as "an important client" from which NSMC had "received income, received profits it was reporting to the public," and stated that "the person at Eastern Airlines who was responsible for National Student Marketing's business was Thomas Mullen." (JA 238, 240). Then, explaining how the Eastern commitment letter had originated, the prosecutor told the jury:

> "... Kelly told Randell that in May of 1969 National Student Marketing had presented to Thomas Mullen at Eastern Airlines a proposal for a program that National Student Marketing proposed to do for Eastern Airlines in the year 1970 and which would cost Eastern Airlines over $800,000 if Eastern Airlines accepted it.
>
> Kelly told Randell that Mullen had stated that he wanted to do it, but at that time there was no contract. There was no commitment from Eastern Airlines to accept this program to spend this money with National Student Marketing in the coming year.
>
> * * *
>
> So Randell told Kelly to go to Mullen and seek a commitment letter from him for Eastern Airlines to spend $800,000 with National Student Marketing in 1970.
>
> Kelly went and in short order came back, came back with a letter from Mullen commiting Eastern as of May 14, 1969 to do $820,000 worth of business with National Student Marketing in 1970, a letter that Mullen had no authority to send." (JA 243-244).

How, then, can the government claim that it did not vouch for the testimony it later elicited from its own witness establishing these same facts?

Moreover, the overriding question is whether Randell was truthful when making the sworn statements upon which we rely. In claiming that he was not, the government relies exclusively on the fact that Randell has been convicted of a felony involving fraud. But this argument proves too much, for the government itself credits at least part of his testimony

in the *Mullen* trials.[16] Apart from Randell's status as a convicted felon, the government offers no reason why the Court should not believe his testimony that NSMC account executive Robert Bushnell spent several months developing an Eastern program and that Mullen had "agreed to go ahead with the program back in May." The documentary evidence available, moreover, is consistent with the truth of these statements. The Eastern program shown to appellant and the time sheets of Robert Bushnell support those aspects of Randell's testimony on which we rely. Indeed, despite all its remarks about lies and liars, the government never really expressly denies that NSMC worked with Eastern for several months to develop a proposal and received oral assurances in May 1969 that Eastern would continue using NSMC's services, and in a much larger volume.[17]

3. The prosecutor's statements to appellant's jury went beyond the testimony of government witnesses.

Notwithstanding these substantial variations, the government argues that the account of Eastern it purveyed to

[16]Furthermore, this presumption of prevarication destroys the government's case against appellant. If Randell must be presumed to be lying, why then can Kurek, who pleaded guilty to the same crime as did Randell and was a principal government witness at appellant's trial, be regarded as truthful? The government seeks to apply a double standard to the testimony of these witnesses: where the testimony supports the government, it is truthful; where the testimony is embarrassing to the government, the witness must be lying. Obviously the Court will not find this proposition serviceable for the evaluation of Randell's testimony in the *Mullen* trials.

[17]Everything said above with respect to Randell's testimony at the *Mullen* trials applies with equal force to his testimony in the deposition taken in the *National Student Marketing* civil litigation, which, on this point, is simply cumulative to his *Mullen* testimony. The government places a sinister interpretation on Randell's uncertainty, in his deposition testimony, as to when appellant first objected to the inclusion of Pontiac, and the government faults Randell for failure to acknowledge the full extent of his complicity in faking the Pontiac letter which was shown to appellant. Again, however, the government does not deny that NSMC's Eastern activity antedated August 1969. Nor is any such denial found in the passage quoted from the SEC's pre-trial brief (Govt. Br. 83-84, n.*), which is said to constitute the government's response to the deposition testimony.

appellant's jury was at least supported by the evidence of record in that trial. The government cites testimony by Kurek and Buck, financial officers of NSMC, that prior to the early morning hours at Pandick Press *they* had never heard of the Eastern commitment. (Br. 61-62.) But the prosecutor went far beyond their testimony in stating to the jury that Eastern had been "hatched" right then at the printer's plant and that "nobody but nobody" at NSMC had ever mentioned it previously (JA 25, 35). Neither Kurek nor Buck (nor, indeed, any other witness) at appellant's trial testified that *nobody* at NSMC had ever discussed Eastern, as the prosecutor claimed. Indeed, neither Buck nor Kurek could have so testified, since as part of NSMC's internal accounting staff located in Washington in the spring and summer of 1969, they lacked complete familiarity with the work of NSMC's account executives, who were located in New York. In asserting, inaccurately, that the Eastern commitment was a "magic" 3 a.m. fabrication without legitimate basis in NSMC's activities, therefore, the government went well beyond the matters as to which its witnesses had testified and, indeed, beyond matters to which they were capable of testifying.

B. Appellant Is Entitled To A New Trial Or, Alternatively, A Hearing In The District Court.

When a factual assertion on a material point is subsequently established as untrue, the trial has failed in its truth-determining function and the conviction should be reversed as a matter of "fundamental fairness essential to the very concept of justice." *Lisenba v. California*, 314 U.S. 219, 236 (1941). *See Campbell v. United States*, 429 F.2d 209 (D.C. Cir. 1970). Since appellant's jury was given a false impression concerning the origin and nature of the Eastern contract, appellant is entitled to a new trial. But even if the court should not agree that a new trial is required by the facts that have now been adduced, appellant is at least entitled to a

hearing to determine whether, as now seems quite probable, the government had in its possession at the time of appellant's trial the information which now establishes the misleading character of the prosecutor's statements to the jury.

When Randell was asked by PMM's counsel at a deposition in April 1976 whether he had ever discussed with the assistant United States attorney who prosecuted appellant the "matters which you have just testified to in response to my questions" (*i.e.*, those concerning, *inter alia*, NSMC's relationship to Eastern), Randell responded that indeed he had discussed those matters with the prosecutor prior to appellant's trial. (Brief of Defendant-Appellant at p. App. 13). The government attempts to argue that the question put to Randell was ambiguous.[18] And with surprising aplomb, unencumbered by any facts, the government denounces Randell's deposition as a "tissue of lies." (Br. 86). Significantly, however, the government does not deny that the conversation between Randell and the prosecutor took place nor does it deny that prior to appellant's trial the history of the Eastern commitment was discussed.[19] We are left, then, with the government's general attack on Randell's credibility and with its objections to judicial notice of the deposition to establish the truth of the matter asserted therein. Whether or not Randell's statements on deposition may be taken as proof of the truth of the matter asserted, however, Randell's statement, coupled with the government's failure to deny, furnish ample basis for an inquiry in the district court on the issues of what the government knew

[18]For example, the government argues that the questionner, by asking whether Randell had discussed "the matters which you have just testified to in response to my questions" leaves open which of the questions "contained in the great many pages" of prior questioning might have been included. (Br. 89). The preceding questions by PMM's counsel, however, are contained in only 7 pages of transcript.

[19]The government represents that Randell's grand jury testimony contains nothing relevant on this point. Also, the government quotes a statement by Judge Tyler, made well before this particular controversy arose, that the government had made its "entire file" available to the defense. (Br. 89-90). These statements by the government are not reassuring in light of Randell's deposition testimony, not denied here, that the prosecutor deliberately refrained from making contemporaneous notes of their conversation.

or should have known at the time of appellant's trial. The statute compels the district court to grant a hearing unless "the motion and the files and records of the case conclusively show" that no relief is warranted. 28 U.S.C. §2255. *See Sanders v. United States*, 373 U.S. 1 (1963). Despite the Solicitor General's representations, the district court refused to hold such a hearing.[20]

The government's final objection is that appellant's trial counsel might have called Randell as a witness (even though Randell's counsel refused to let defense counsel interview him) but did not do so. This, argues the government, renders appellant's claim "moot." (Br. 88.) The issue here, however, is not the strategic decisions made by appellant's trial counsel but the government's failure to observe those principles of fairness which govern its conduct as advocate. Whatever the defense counsel's choices concerning litigation strategy, the government remains bound to "refrain from improper methods calculated to produce a wrongful conviction." *Berger v. United States*, 295 U.S. 78, 88 (1935). The government's obligation to refrain from creating a "false impression," *Alcorta v. Texas, supra*, applies with equal force in every trial, regardless of the way in which the defendant chooses to make his defense. Indeed, the defendant has an absolute right to stand mute if he chooses, and it is no excuse for government distortion to say that the defense could have refuted it.

The government tries here, as in the district court, to force this case into the mold of a routine newly-discovered evidence case, in which the defense comes forward with evidence unknown to the government at the time of trial. In such a case it is generally appropriate to refuse relief to the defendant if by exercising due diligence the defendant could

[20]Since the government does not dispute the fact that Randell made the statements during his deposition, the Court can plainly take judicial notice of the deposition under Fed. R. Ev. 201 for the purpose of determining whether appellant is entitled to a hearing in the district court. If the government challenges the truth of Randell's statements concerning his meeting with the prosecutor, that challenge should be resolved by the district court.

have produced the evidence at his trial. Quite different, however, is a case such as this one, involving affirmative representations by the government that apparently distorted the truth-seeking function of the trial. In such a case, the government cannot excuse its own misconduct by faulting the defense. *See Washington v. Vincent*, 525 F.2d 262 (2d. Cir. 1975), *cert. denied*, 424 U.S. 921 (1976).

The courts have long distinguished cases involving some form of government misconduct from the run-of-the-mill discoveries of allegedly new evidence. For example, in *United States v. Stofsky*, 527 F.2d 237 (2d. Cir. 1975), cited by the government, the court refused to grant a new trial because of later-discovered perjury by the government's principal witness, observing that while the defense had materials establishing the perjury at the time of trial, "the same charge does not lie against the government," which did not have the materials in its possession. *Id.* at 245. Accordingly, the court concluded that the perjury was "not the product of governmental misconduct justifying application of the looser standards of post-trial review governing such cases." *Id.*

The claim here is not that the government "suppressed" Randell's later testimony, but that the government through repeated statements to appellant's jury created the false impression that NSMC's Eastern commitment lacked any legitimate basis in NSMC's prior activity and was instead a fictitious invention. There is ample evidence now to demonstrate the inaccuracy of the picture the prosecutor painted and this should suffice to require a new trial. When coupled with indications the inaccurate version may not have been inadvertent, relief is surely warranted.

CONCLUSION

Appellant's conviction should be set aside and a new trial granted as to the first specification of falsity. Alternatively, the district court's denial of appellant's motion should be reversed and the case remanded with directions to hold an evidentiary hearing to determine what information was in the government's possession at the time of appellant's trial.

Respectfully submitted,

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Dated: February 28, 1977

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA, Appellee,	:	
v.	:	Docket No. 76-1494
ANTHONY M. NATELLI, Defendant-Appellant.	:	

76-1494

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of February, 1977, I caused two copies of the Reply Brief of Defendant-Appellant, Anthony M. Natelli, to be hand-delivered to:

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